ICRA

STATE GOVERNMENT FINANCES

Gross SGS issuance estimated at Rs. 9.5 trillion in FY2024

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SUMMARY

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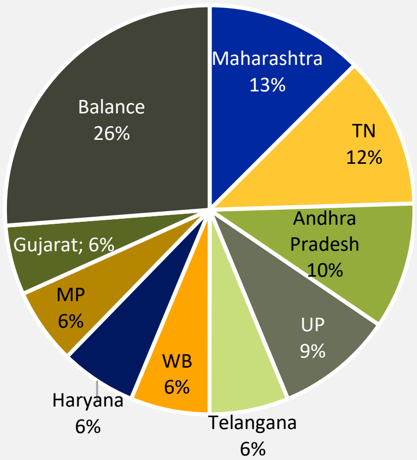
Exhibit: State-wise share in Q1 FY2024 indicative SGS issuance



The Reserve Bank of India (RBI) has pegged the gross issuance of State Government Securities (SGS) at Rs. 2.0 trillion for Q1 FY2024, a year-on-year (YoY) expansion of 81.4% on the low base of Q1 FY2023. The latter had been impacted by the change in guidelines related to finalisation of the net borrowing ceiling (NBC) of the state governments for FY2023 by the Government of India (GoI) in Q1 FY2023. Reflecting the impact of these guidelines, the fresh off-budget borrowing of the states is estimated by the GoI to have reduced to Rs. 185 billion in FY2023 from Rs. 666 billion in FY2022, driven by Telangana and Kerala.

In FY2024, the reduction in the Goods and Services Tax (GST) compensation to the states as well as the borrowing limit by 0.5% of Gross State Domestic Product (GSDP) in FY2024 relative to FY2023, would compress the resources available to the states for funding their deficit. However, the GoI has enhanced the allocation under the interest-free capex loan to the states to Rs. 1.3 trillion in the budget estimates (BE) for FY2024 from Rs. 760 billion in the revised estimates (RE) for FY2023. Based on the back-ended and lower-than-budgeted utilisation of the capex loan in FY2023, the GoI seems to have tightened the guidelines for this scheme for FY2024. Faster identification of projects by the states, which are to be funded under this scheme, could eventually result in a less back-ended disbursement of funds by the GoI, and impact the borrowing requirement of the states in FY2024. At present, we estimate the gross and net SGS issuance in FY2024 at Rs. 9.5 trillion and Rs. 6.7 trillion, respectively, up from Rs. 7.6 trillion and Rs. 5.2 trillion, respectively, in FY2023.

- **SGS issuance for Q1 FY2024 indicated at Rs. 2.0 trillion:** 22 state governments and two Union Territories (UTs) have indicated borrowings of Rs. 2.0 trillion for Q1 FY2024, with Maharashtra, Tamil Nadu (TN), Andhra Pradesh (AP) accounting for around a third of this amount. The Q1 FY2024 indicated borrowing is ~81% higher on a YoY basis, with the bulk of the incremental gross borrowing of Rs. 897 billion in Q1 FY2024 relative to Q1 FY2023 led by Uttar Pradesh (UP; by 185 billion), TN (by Rs. 160 billion), Madhya Pradesh (MP; by Rs. 100 billion), Punjab (Rs. 97 billion) and Kerala (Rs. 65 billion). The high ~81% YoY growth is somewhat distorted as some of the states' actual borrowing in Q1 FY2023 was impacted by the delay in finalisation of the borrowing limit for FY2023 in light of the change in borrowing guidelines.

- **Utilisation of capex loan in FY2024 could impact actual SGS issuance:** The increase in allocation by the GoI to the interest-free capex loan to the states in FY2024 relative to FY2023 is likely to cushion the impact of scheduled reduction in their NBC as well a sharp dip in the GST compensation grants. While the borrowing under the capex scheme is over and above the normal borrowing limit of the states, the execution capacity of the states would influence the scaling-up of capital spending over a 12-month period.

- **ICRA estimates gross issuance in FY2024 at Rs. 9.5 trillion, 25.7% higher on a YoY basis:** Based on the borrowing limit of 3.0% of GSDP for FY2024, we estimate the net issuance at Rs. 6.7 trillion in FY2024, 28.8% higher on a YoY basis. With the increase in the SGS redemptions to Rs. 2.9 trillion in FY2024 from Rs. 2.4 trillion in FY2023, we project the gross SGS issuance to rise to Rs. 9.5 trillion in FY2024. The planned issuance for Q1 FY2024 is equivalent to ~21% of our estimate of the gross SGS borrowing for FY2024.

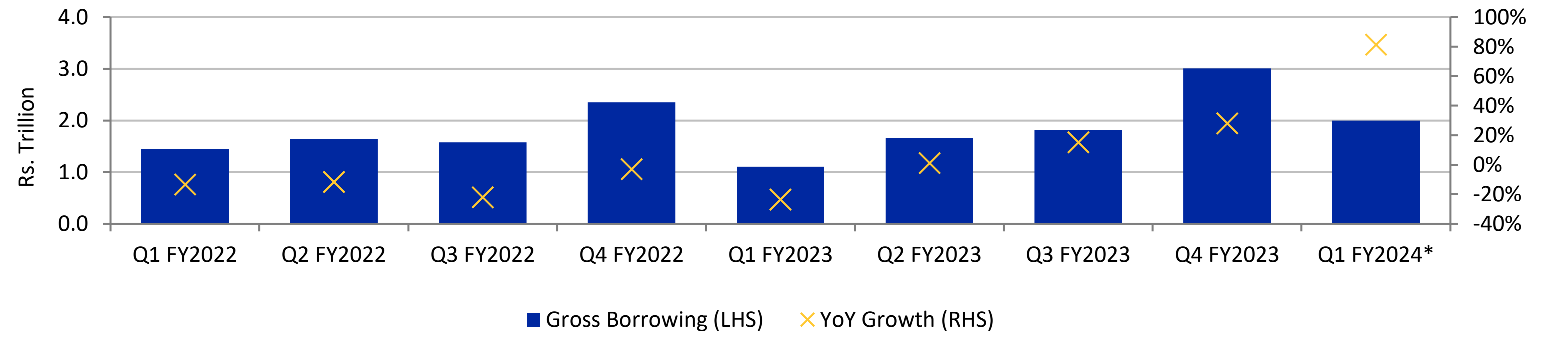
24 states/UT have indicated borrowings of Rs. 2.0 trillion for Q1 FY2024, 81.4% higher on a low base

GROSS SGS ISSUANCE IN Q1 FY2024 INDICATED AT RS. 2.0 TRILLION, YOY EXPANSION OF ~81% ON A LOW BASE

The auction calendar of market borrowings by 22 state governments and two UTs for Q1 FY2024, released by the RBI on March 31, 2023, has pegged their total indicative market borrowing at Rs. 2.0 trillion. This is a substantial 81.4% higher than the actual borrowing of Rs. 1.1 trillion in Q1 FY2023, which had been impacted by the change in the borrowing guidelines by the GoI for determining the NBC of the state governments for FY2023, among other factors (refer Exhibit 1). The actual borrowing in Q1 FY2023 was ~42% lower than the indicated Rs. 1.9 trillion. Accordingly, the indicative borrowing for Q1 FY2024 is only slightly higher than the amount initially indicated for Q1 FY2023.

We estimate the SGS redemptions to rise modestly to Rs. 492 billion in Q1 FY2024 from Rs. 485 billion in Q1 FY2023. Accordingly, the net SGS issuance in Q1 FY2024 is assessed at Rs. 1.5 trillion, more than double the net issuance of Rs. 0.6 trillion in Q1 FY2023.

Exhibit 1: Gross SGS issuance by all state governments/UTs and their YoY growth



*Note: * FY2024 based on Q1 indicative borrowing and YoY growth is over actual SGS issued in Q1 FY2023*
Source: RBI; ICRA Research

MAHARASHTRA, TN, AND AP TO ACCOUNT FOR A THIRD OF THE BORROWING INDICATED FOR Q1 FY2024

The indicated borrowings of Maharashtra (Rs. 250 billion), TN (Rs. 240 billion) and AP (Rs. 200 billion) account for ~35% of the total issuance of Rs. 2.0 trillion by 24 states/UTs for Q1 FY2024. Arunachal Pradesh, Bihar, Jharkhand, Karnataka, Manipur, and Odisha have not indicated their participation in the Q1 FY2024 auction calendar.

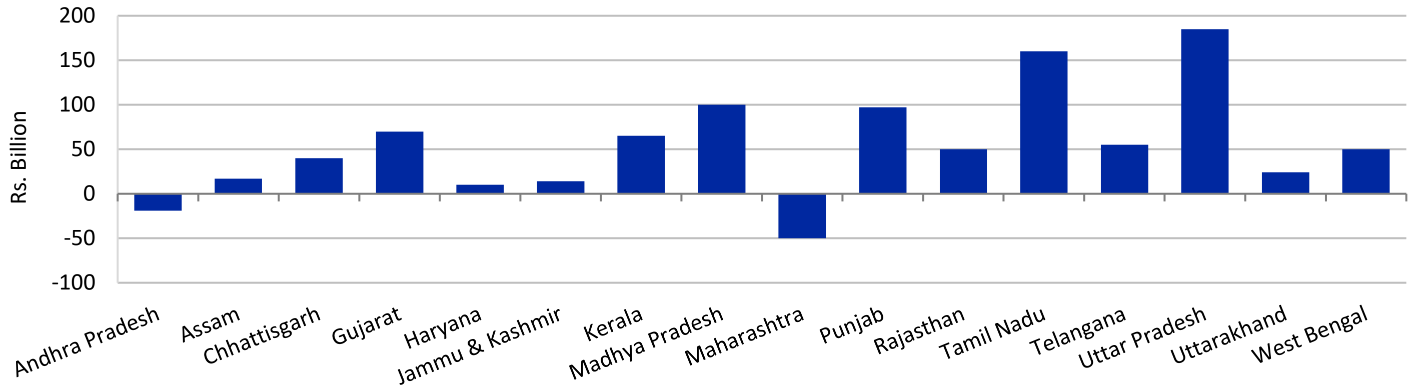
The incremental gross borrowing of Rs. 0.9 trillion in Q1 FY2024 relative to the actual issuance in Q1 FY2023 is led by UP (Rs. 185 billion vs nil), TN (Rs. 240 billion vs Rs. 80 billion), Madhya Pradesh (Rs. 120 billion vs. Rs. 20 billion), Punjab (Rs. 127 billion vs. Rs. 30 billion), Gujarat (Rs. 110 billion

Three-fourth of the incremental borrowing of Rs. 897 billion in Q1 FY2024 relative to Q1 FY2023 is led by TN, MP, Punjab, Gujarat, and Kerala; Maharashtra and AP have indicated a YoY dip in borrowing in Q1 FY2024.

vs. Rs. 40 billion) and Kerala (Rs. 80 billion vs. Rs. 15 billion; refer Exhibit 2). These six states have indicated combined incremental borrowing of Rs. 677 billion in Q1 FY2024, around three-fourths of the total increase of Rs. 897 billion, on a YoY basis.

Notably, the modest amount of issuance by Kerala in Q1 FY2023 was likely to have been on account of the finalisation of the adjustment of the incremental off-budget debt of FY2022 in FY2023. Out of the assessed Rs. 666 billion incremental off-budget debt by the GoI for FY2022 that would be adjusted during FY2023-26, Telangana's share was the highest at Rs. 353 billion followed by Kerala at Rs. 143 billion. While Telangana has indicated borrowing of Rs. 125 billion in Q1 FY2024, higher than Rs. 70 billion in Q1 FY2023, it is lower than the Rs. 135 billion it borrowed in Q1 FY2022, wherein no off-budget related adjustment was applicable.

Exhibit 2: Incremental SGS issuance in Q1 FY2024 relative to Q1 FY2023 of top 15 state governments



Source: RBI; ICRA Research

GoI estimated the incremental off-budget debt to decline to Rs. 185 billion in FY2023 from Rs. 666 billion in FY2022

Encouragingly, in February 2023, the GoI estimated a sharp ~72% drop in the off-budget debt of the states for FY2023 to Rs. 185 billion, with Telangana's share declining to Rs. 8 billion and Kerala's to Rs. 28 billion (Source: Rajya Sabha website). **The off-budget debt was not subjected to strict oversight prior to the guidelines issued by GoI in FY2022. Accordingly, the estimated decline in the off-budget debt in FY2023 relative to the levels in FY2022, is a desired outcome of the steps taken by the GoI in FY2023 to curtail the off-budget debt of some of the states, which had risen sharply in recent years. This had posed concerns about the potential servicing of the off-budget debt by the state governments as it could materially widen their deficits and compress the fiscal space available for other priorities at the time of the servicing.**

As per the GoI's guidelines issued in FY2022, the incremental off-budget debt of FY2022 would be adjusted over a period of four years between FY2023-26 and the off-budget borrowings made from FY2023 onwards shall be considered as borrowings made by the state itself for the purpose of issuing the consent under Article 293(3) of the Constitution of India.

Additionally, among the large borrowers, Maharashtra (Rs. 250 billion vs. Rs. 300 billion) and AP (Rs. 200 billion vs. Rs. 219 billion), have indicated a lower borrowing in Q1 FY2024 relative to their actual borrowing in Q1 FY2023.

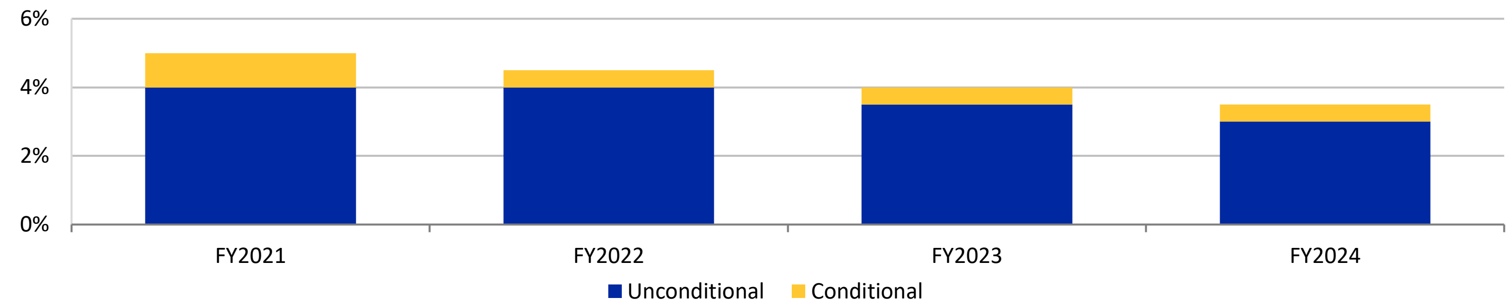
The Q1 FY2024 auction calendar has pegged the SGS issuance in April 2023 at Rs. 582 billion or 29% of the indicated Rs. 2.0 trillion. Out of the four weekly auctions to be held in April 2023, in the first auction dated April 5, 2023 (Wednesday), only AP would be issuing SGS worth Rs. 30 billion. The size of the remaining three SGS auctions in April 2023 will vary between Rs. 138 billion and Rs. 225 billion. Subsequently, Rs. 745 billion SGS is proposed to be issued in May 2023 (37% of the total), in five weekly auctions, with the size of the auctions ranging between Rs. 77-216 billion. The balance Rs. 673 billion (34% of the total) SGS indicated for Q1 FY2024 is expected to be issued in June 2023, with a weekly size ranging from Rs. 118-236 billion.

Lower Net Borrowing Ceiling and GST Compensation grants to states in FY2024 to influence their fiscal space

The GoI had approved the the NBC of 3.0% of GSDP (additional borrowing of 0.5% of GSDP for power sector reforms) for FY2024 for the state governments, recommended by the Fifteenth Finance Commission (15^{th} FC) from 3.5% of GSDP in FY2023 (additional borrowing of 0.5% of GSDP for power sector reforms; refer Exhibit 3).

Reduction in GST compensation and borrowing limit by 0.5% of GSDP in FY2024 relative to FY2023, would compress the resources available to the states for funding their deficits

Exhibit 3: NBC as a percentage of GSDP for state governments during FY2021-FY2024



Source: FC reports; ICRA Research

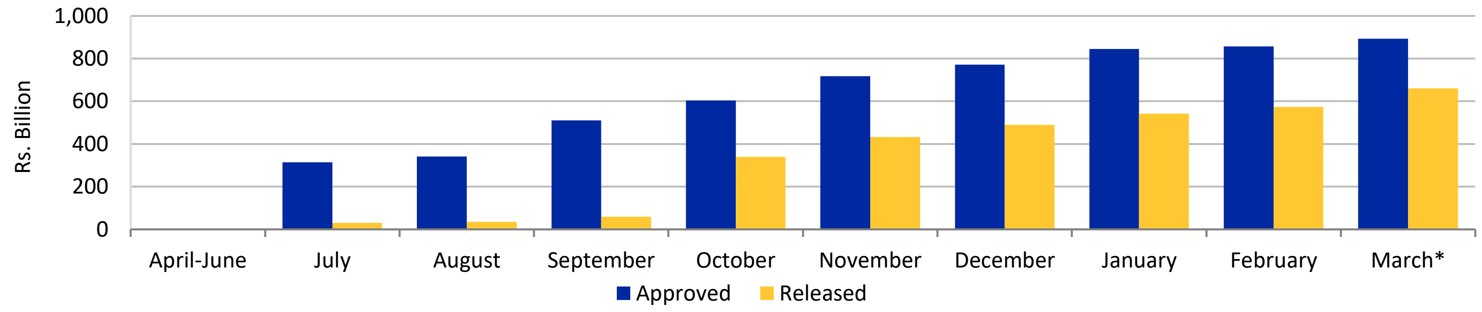
Moreover, in the Union Budget FY2024, the GoI has included Rs. 431 billion as GST compensation grants for the states for FY2024, even as the GST compensation period ended on June 30, 2022, in line with the provisions laid down in the GST (Compensation to States) Act, 2017. Even if this amount is fully released to the states in FY2024, it will be sharply lower than the Rs. 1.5 trillion released in FY2023. **The reduction in the GST compensation as well as the borrowing limit by 0.5% of GSDP in FY2024 relative to FY2023, would compress the resources available to the states for funding their deficits in FY2024.**

Rs. 1.3 trillion interest-free capex loan, which is over and above the normal borrowing limit, is equivalent to 0.4% of ICRA's estimate of FY2024 GSDP

In the Union Budget FY2024, the GoI increased the allocation for the "Special Assistance as Loan to States for Capital Expenditure" scheme (interest-free capex loans) to Rs. 1.3 trillion from Rs. 760 billion in the FY2023 RE (reduced from Rs. 1.0 trillion in FY2023 BE). The enhanced amount of the interest-free capex loan scheme would support the state governments in funding their FY2024 fiscal deficits as the NBC for FY2024 is set to decline by 0.5% of GSDP in FY2024 from FY2023. The Rs. 1.3 trillion interest-free capex loan, which is over and above the normal borrowing limit, is equivalent to 0.4% of ICRA's estimate of FY2024 GSDP.

Till March 22, 2023, Rs. 893 billion had been approved by the GoI under the capex-scheme (refer Exhibit 4), which is higher than the Rs. 760 billion included in FY2023 RE. Against this amount, Rs. 660 billion was released to states which was equivalent to ~74% of the approved amount on that date. **In FY2023, the offtake of this loan was nil in Q1 FY2023, muted in Q2 FY2023, picked-up from October 2023 onward, revealing a highly back-ended pattern of offtake. The GoI has made some changes to the guidelines for the capex scheme, which we hope will nudge an early start of the process of availing loans under the capex scheme by the states and increase in the overall utilisation levels of the enhanced allocation in FY2024 relative to the trend seen in FY2023.**

Exhibit 4: Month-wise approved and released inter-free capex loan to states

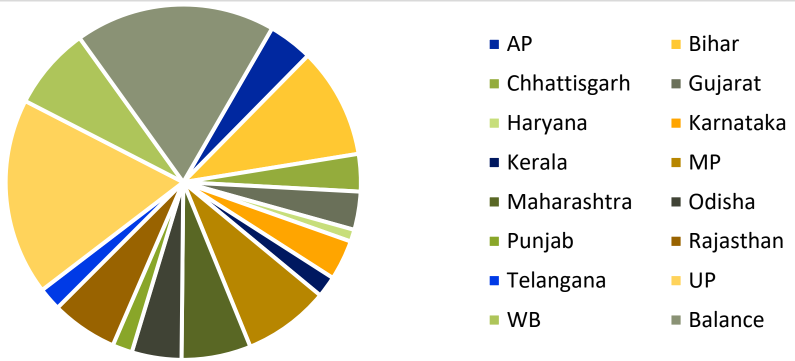


Note: March data is available till March 22, 2023
Source: Ministry of Finance; CGA; Lok Sabha; ICRA Research

As per information available in the public domain, out of the total Rs. 1.3 trillion, Rs. 1.0 trillion will be untied and will be divided amongst the states based on their FC-recommended inter-se applicable for FY2022-26 (refer Exhibit 5). The untied portion will be transferred to the states in three equal instalments and the second instalment will be transferred when a state has utilised at least 75% of the first instalment. Additionally, the third instalment will be on-lent when a state has utilised **75% of the first two instalments and 45% of its capex target**. Moreover, if a state is unable to utilise the third instalment in FY2024, the unutilised amount will be deducted from the FY2025 net borrowing ceiling or the share in the capex scheme (if it continues) of that state.

To ensure a more even pattern of availing the capex loan and improvement in the utilisation levels of the enhanced loan amount in FY2024 relative to FY2023, the GoI has changed the guidelines for this scheme

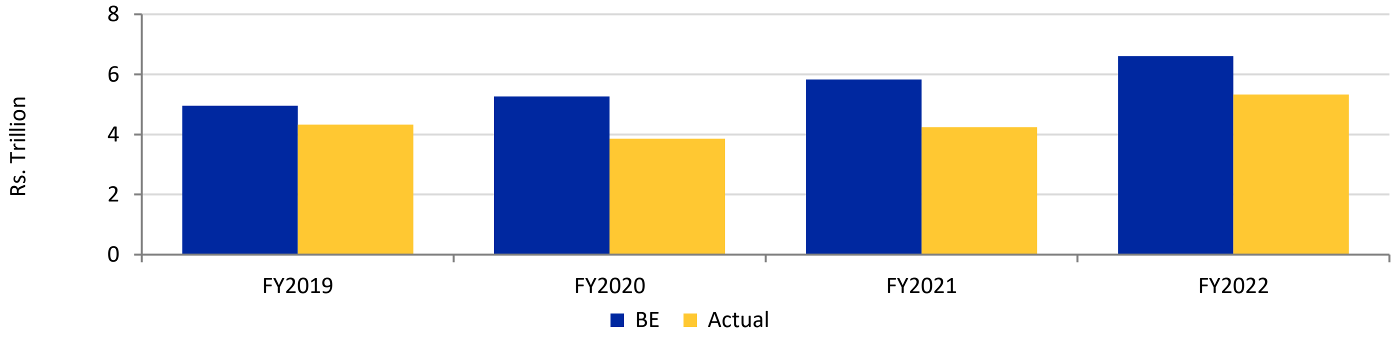
Exhibit 5: Estimated share in the untied portion of interest-free capex scheme based on the state's inter-se in FY2024



Source: FC report; ICRA Research

The GoI funding available under the capex-loan scheme is over and above the normal borrowing limit of the states. Our interpretation of the revised tighter guidelines for the capex loan scheme for FY2024 is that the GoI may be intending for these funds to supplement, not finance budgeted capex, or help to ensure that a minimum capex target is completed. The recent years have been marked by a trend of lower-than-budgeted capital spending by many of the states (refer Exhibit 6).

Exhibit 6: Combined capital outlay and net lending of all states



Source: State Budgets; CAG; RBI; ICRA Research

We remain circumspect whether the states will be able to fully utilise the Rs. 1.3 trillion capex loan, and their ability to scale up execution will be critical. We had studied the state budgets of 15 large states, amongst those states only 12 states had included an estimate for this scheme in FY2024 BE and the combined allocation was expected to increase to Rs. 571 billion in FY2024 BE from Rs. 471 billion in FY2023 RE. Additionally, the pattern and areas of capital spending in FY2024 may be impacted by Assembly elections in several large states, such as, Karnataka, Telangana, Rajasthan, and MP are expected over the course of 2023.

ICRA ESTIMATES GROSS SGS ISSUANCE OF RS. 9.5 TRILLION IN FY2024

ICRA estimates gross SGS issuance at Rs. 9.5 trillion and net issuance at Rs. 6.7 trillion for FY2024

Based on ICRA's estimate of FY2024 GSDP for the 28 states and 2 UTs, we have forecast the aggregate net borrowing limit of the state governments at Rs. 8.9 trillion for FY2024. If 75% of this limit is utilised by the states for funding their deficits through SGSs, **the net issuance would increase by 28.8% YoY to Rs. 6.7 trillion in FY2024 from Rs. 5.2 trillion in FY2023 (refer Exhibit 7). ICRA estimates the SGS redemptions to rise to Rs. 2.9 trillion in FY2024 from Rs. 2.4 trillion in FY2023. This implies that the gross SGS issuance would step up by 25.7% to Rs. 9.5 trillion from Rs. 7.6 trillion, respectively. Accordingly, the issuance planned for Q1 FY2024 is equivalent to ~21% of our estimate of the gross SGS borrowing for FY2024.**

Exhibit 7: Net and gross SGS issuance estimate in FY2024 and YoY growth

Amount in Rs. Trillion	FY2021	FY2022	FY2023 (A)	FY2024 E (B)	YoY growth (B/A)
Net Borrowing	6.5	4.9	5.2	6.7	28.8%
Redemption	1.5	2.1	2.4	2.9	19.0%
Gross Borrowing	8.0	7.0	7.6	9.5	25.7%

Source: RBI; ICRA Research

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